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Foreign Economic Trends and Their Implications for the United States

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KEY ECONOMIC INDICATORS
In millions of U.S. dollars unless noted

	Actual 1988	Actual 1989	Proj. 1990
Domestic Economy			
Population (mil., year-end)	19.9	20.1	20.2
Population growth (%)	1.2	1.0	1.0
GNP in current dollars	125,316	150,255	164,700
Per Capita GNP ($)	6,333	7,509	8,159
Real GNP growth (NT$ terms)	7.8	7.2	6.7
Consumer price % change	1.3	4.4	3.4
Production and Employment			
Labor force (millions)	8.2	8.4	8.6
Unemployment rate (average)	1.7	1.6	1.8
Industrial production, % change	4.4	3.7	-2.0
Govt. oper. balance as % of GNP	3.0	-0.9	-7.3
Balance of Payments			
Exports (fob)	60,585	66,201	66,000
Imports (cif)	46,778*	52,231**	57,000
Trade surplus	13,807*	13,970**	9,000
Current account balance	10,177	11,145	6,494
Foreign direct investment	959	1,638	1,500
External public debt (12/31)	1,871	1,404	1,000
Debt-service paid	1,702	970	600
Debt-service ratio as % of exports (goods and services)	2.6	3.4	2.5
Forex reserves (year-end)	73,897	73,224	63,000
Average NT$/US$ exchange rate	28.6	26.4	27.0
Foreign Investment Approvals			
Total (since 1952)	8,532	10,950	12,950
U.S. (since 1952)	2,710	3,091	3,391
U.S. share (%)	31.8	28.2	26.2
U.S.-Taiwan Trade			
Exports to U.S. (fob)	23,431	23,996	22,704
Imports from U.S. (cif)	10,124*	11,995	13,680
Trade surplus	13,307*	12,001	9,024
U.S. share of exports	38.7	36.2	34.4
U.S. share of imports	21.6	23.0	24.0

Principal Imports from the U.S. (1989): electronic/electrical goods ($1,954); chemicals ($1,409); machinery ($1,389); food/wine/cigarettes ($603); corn ($574); soybeans ($506).

Principal Exports to the U.S. (1989): electronic/electrical goods ($5,873); machinery ($2,245); textiles/apparel ($2,135); footwear ($1,903); toys/sporting goods ($1,512).

* excluding $2,878 million in Central Bank gold imports.
** excluding $18 million in Central Bank gold imports.
Note: Taiwan trade data may not agree with U.S. data.
Source: Directorate General of Budget, Accounting and Statistics.

SUMMARY*

Taiwan's economy rebounded slightly in the first quarter of 1990--posting 7.4 percent growth. This rate approximated 1989's moderate 7.2-percent growth but fell below the double-digit growth spurts achieved by South Korea and Singapore. Taiwan authorities predict 7-percent growth for 1990 as a whole. However, many private economists continue to forecast a lower growth rate of around 5 or 6 percent, chiefly because of continued capital outflow, labor shortages, and slower industrial growth.

The increasing offshore relocation of labor-intensive industries has led to a dramatic slowdown in Taiwan-sourced exports and domestic private investment. Political uncertainty surrounding the March 1990 presidential elections may have contributed to the rising capital outflow. As a result, the amount of bank credit available has been severely reduced, interest rates pushed up, and real estate demand dampened. Capital outflow also depressed the stock market (down 60 percent from January to June) and may translate into somewhat higher unemployment in 1990.

Taiwan's export growth is currently flat, although export shipments from offshore bases have risen. The value of imports--stimulated by duty cuts in August 1989 and commodity tax reductions in January 1990--is rising; but real import growth has slowed. AIT's current projections show imports rising 11 percent (from $52 billion in 1989 to $57 billion in 1990) while exports remain virtually at the same level ($66 billion). If our estimate holds, the global trade surplus should decline by a third--dropping from $13 billion in 1989 to $9 billion in 1990.

The relocation of industrial plants offshore should continue to reduce the U.S. share of Taiwan's total exports from 36 percent ($24 billion) in 1989 to an estimated 34 percent ($22.7 billion) in 1990. At the same time, the share of imports from the United States may rise from 23 percent ($12 billion) to 24 percent ($13.7 billion). Taiwan's trade surplus with the United States--which fell 9.8 percent in 1989--may drop another 25 percent in 1990, according to Taiwan's data. This drop, if realized, is well ahead of the annual 10-percent reduction target set in Taiwan's Trade Action Plan (TAP) for 1989-92. However, U.S. Department of Commerce (USDOC) data indicate that the gap reduction will be smaller. According to USDOC data, the U.S.-Taiwan trade gap fell 13.4 percent in the first five months of 1990 compared with the same period a year ago.

Several trade consultations helped to further liberalize and internationalize Taiwan's economy. Among other achievements,

*This report was prepared in June 1990.

foreign banks are now able to accept more local currency deposits, set up additional branch offices, and expand into investment banking. Restrictions on U.S. insurance companies have been relaxed somewhat. Intellectual property rights protection has been further strengthened.

However, more work remains in advancing U.S.-Taiwan mutual economic interests. Agricultural goods, automobiles and distilled spirits, among other products, are still subject to high tariff and non-tariff barriers. Foreign banks and insurance companies are restrained by quotas limiting their entry into the Taiwan market. The local securities market remains largely closed to foreign firms. Finally, Taiwan's copyright law requires additional revisions to meet international standards for the protection of intellectual property.

CURRENT ECONOMIC SITUATION

GNP Growth: Taiwan's economy--which grew 7.2 percent in 1989--grew a moderate 7.4 percent in the first quarter of 1990. This figure is considerably lower than the double-digit performances of South Korea and Singapore, Taiwan's two major trade competitors in East Asia. Per capita GNP increased from $6,333 in 1988 to $7,509 in 1989--roughly comparable to that of Greece and on a par with the low- to middle-rank countries in the Organization for Economic Cooperation and Development. Per capita GNP is likely to exceed $8,000 in 1990.

Current trends may make it difficult for Taiwan to sustain a growth rate of 7 percent in 1990. Agriculture continued its 1989 decline into the first quarter of 1990. During the same period, as export industries stepped up their emigration, industrial production on Taiwan experienced its first quarterly decline in 15 years. Capital outflow has greatly reduced liquidity, dampened the real estate and stock markets, and weakened the service sector, the main engine for Taiwan's economic growth in 1989.

Foreign Trade: In the first half of 1990, Taiwan's exports ($31.9 billion) fell 0.8 percent--the first such half-year drop in 16 years. On the import side, tariff cuts in August 1989 and commodity tax reductions in January 1990 have helped stimulate brisk sales of imported consumer goods. Imports rose 11.7 percent in 1989 to $52.2 billion and increased another 3.9 percent to $26.9 billion in the first half of 1990 compared with the same period of 1989. As a result, the trade surplus--which inched up 1.2 percent in 1989 to $13.0 billion--fell 20.1 percent to $4.9 billion in the first half of 1990, according to Taiwan statistics.

The New Taiwan Dollar: Taiwan's currency depreciated 3.9 percent against the U.S. dollar in the first half of 1990--rising from 26.17:1 to 27.20:1. Public expectation

regarding a weaker new Taiwan dollar (NT$) was so strong in mid-1990 that the Central Bank acquiesced to a lower NT$:US$ exchange rate--down from 26.50:1 to 27.50:1, ten minutes before the close of the May 15 session. This was the largest single-day depreciation in 11 years.

In order to reduce foreign exchange speculation, the Central Bank stipulated that foreign exchange banks must set aside a certain percentage of reserves for foreign currency deposits, effective June 23. As a result of this directive and other Central Bank actions, the NT$:US$ has since fluctuated within a small range between 27.10:1 and 27.30:1.

Monetary Policy and Inflation: Taiwan authorities believe that a 10-15 percent growth in money supply (M1B) is appropriate for controlling domestic inflation and sustaining economic growth. Given the massive capital flows over the past five years, the Central Bank has seen major changes in the stock and expansion of money. During 1986-87, when capital flowed into Taiwan, the Central Bank issued bonds and certificates of deposits in large amounts. Nonetheless, with a rise in the rediscount rates, the bank could not prevent M1B growth from exceeding 50 percent. By early 1989, however, capital outflow had slowed M1B growth from double to single digits.

In March 1990, the Central Bank apparently changed monetary course--attempting to ease credit somewhat through intensive open market operations. So far, the bank has failed to prevent a decline in money supply. The pace of the decline (seasonally adjusted) accelerated from 0.5 percent in March to 3.4 percent in May 1990.

Although capital outflow has reduced demand-pull inflationary pressures, cost-push pressures remain. Heavy rains and typhoons drove up agricultural prices in early 1990. Wage hikes continued to outpace labor productivity. As a result, manufacturing labor costs per unit have increased--up 10.7 percent in the first quarter of 1990. In addition, a record 13-percent pay raise for public servants and a 10-30 percent increase in transportation fares--both scheduled for July--are likely to prevent the 1990 consumer price index (CPI) from dropping below the 3.9-percent pace set in the first half of 1990. (According to several economists, Taiwan's CPI seriously understates the inflation rate, chiefly by underestimating housing costs.)

OUTLOOK FOR 1990

Taiwan authorities predict 7-percent growth for 1990 as a whole. However, many private economists continue to forecast a lower growth rate of around 6 percent--chiefly because of continued capital outflow, labor shortages, and slower

industrial growth. Indeed, capital outflow might further weaken the stock exchange and prolong the current recession in the housing industry. Unemployment will likely rise if weaker performance in the financial services sector leads to significant layoffs. Paradoxically, manual labor shortages should remain a key constraint for major public construction projects. Public consumption and investment will likely rise, but perhaps not enough to pick up the slack in private consumption.

Investment Climate: While Taiwan's economy has enjoyed relatively strong growth over the past two years, its investment climate has deteriorated. Overall currency appreciation, high labor costs, labor shortages, increased land costs, and new antipollution regulations have contributed to industrial emigration. Approximately 63 percent of Taiwan's total overseas investment ($10.9 billion) is in the United States and 26 percent in Europe, with the remainder largely in Southeast Asia, Central America, and mainland China.

Some firms have cited their concern about the decline in social order as a factor in their move overseas. One-third of the island's business firms have been affected by crime, according to a February 1990 official survey. A private investigation suggests even higher figures for the number of affected enterprises. The new cabinet has made the safety of business operations a high priority. Premier Hau Pei-tsun has personally taken charge of an anti-crime program and approved the mobilization of military forces to crack down on smuggling (weapons, drugs, and other contraband) and illegal entry into Taiwan.

The new cabinet is also seeking to respond to environmentalists' concerns on the construction of such long-delayed major projects as the fourth nuclear power plant and two naphtha crackers. These facilities, along with infrastructural projects, including those aimed at improving transportation, are viewed as essential to Taiwan's continued economic growth. The leadership is committed to finding ways to reduce the high land and labor costs which now hinder investment.

Ongoing Economic Transformation: Taiwan began encouraging the development of capital and technology-intensive industries well before labor-intensive industries started relocating two years ago. Under the Investment Encouragement Statute (IES), which expires at the end of 1990, industries have been given tax holidays of four to five years and permitted duty-free imports of machinery and equipment.

A new law, designed to upgrade the economic structure, will replace the IES. Tax holidays will be eliminated in the Statute for the Upgrading of Industries (SUI) but other incentives--special tax deductions, accelerated depreciation of machinery costs, and permission to retain more earnings--will be offered to entrepreneurs investing in such fields as information technology, civil aviation, energy, telecommunications, production automation, and biotechnology. In return, these businesspeople have to commit to a program of research and development and acquisition of foreign technology. The banking community has already begun to provide financial support for the acquisition of foreign high-tech companies such as Wyse Technology in the United States.

Relations with the International Community: Taiwan has actively sought to raise its international profile, seeking a greater role for itself in the international trade and banking communities. On January 1, 1990, Taiwan--under the name, "The Customs Territory of Taiwan, Penghu, Kinmen, and Matsu"--formally submitted an application as a developed economy for contracting party status in the General Agreement on Tariffs and Trade (GATT). The GATT has not yet acted on Taiwan's application. After a two-year boycott of Asian Development Bank (ADB) activities, Taiwan resumed attendance of the bank's annual meeting in Manila in 1988 and in Beijing in 1989. At the May 1990 ADB meeting in New Delhi, Taiwan committed $4 million to the Asian Development Fund. Taiwan has informally expressed its desire to be involved in the World Bank.

Taiwan has also used its large foreign exchange reserves to promote foreign relations. In October 1988, it set up the International Economic Cooperation Development Fund to offer aid to countries that are friendly, though not necessarily prepared to recognize Taiwan diplomatically. Capitalized at NTD 30 billion ($1.1 billion), the fund had received 42 applications from 28 countries and approved $150 million for 9 projects by the end of June 1990.

Finally, Taiwan is seeking to expand its role in regional fora such as the Pacific Basin Economic Council (PBEC). Taiwan's representative became the PBEC international president in June. Taiwan has also expressed its desire to join the Asia Pacific Economic Cooperation on an equal footing with other economic entities in the region.

IMPLICATIONS FOR THE United States

Export diversification--coupled with the relocation of industrial plant offshore--should continue to reduce the U.S. share of Taiwan's total exports, down from 36 percent ($24

billion) in 1989 to an estimated 34 percent ($22.7 billion) in 1990. At the same time, the share of imports from the United States may rise from 23 percent ($12 billion) to 24 percent ($13.7 billion).

Chiefly because of rising imports from the United States, Taiwan's trade surplus with the United States--which fell 9.8 percent in 1989--may drop another 25 percent in 1990 (based on current trends in Taiwan data). This drop, if realized, is well ahead of the annual 10-percent reduction target set in Taiwan's Trade Action Plan for 1989-92. However, U.S. Department of Commerce (USDOC) data--which identify U.S. imports by value-added/country-of-origin definitions rather than final shipping point--indicate that the gap reduction would be smaller. According to USDOC data, the U.S.-Taiwan trade gap fell 13.4 percent in the first five months of 1990 compared with the same period a year ago.

Several consultations between the American Institute in Taiwan and the Coordination Council for North American Affairs have further strengthened U.S.-Taiwan economic relations in the first half of 1990. Among other milestones, banking regulations were promulgated in March 1990 permitting foreign banks to accept more local currency deposits, set up additional branch offices, and expand into investment banking. Restrictions on U.S. insurance companies were also relaxed somewhat, and intellectual property rights protection was strengthened.

However, more work remains in advancing U.S.-Taiwan mutual economic interests. Agricultural goods, automobiles and distilled spirits, among other products, are still subject to high tariff and non-tariff barriers. Foreign banks and insurance companies are restrained by quotas limiting their entry into the Taiwan market. The local securities market remains largely closed to foreign firms. Finally, Taiwan's copyright law requires additional revisions to meet international standards for the protection of intellectual property.

Best Prospects for U.S. Exports

U.S. firms will find major opportunities in the following fields.

Pollution Control: Taiwan is expected to invest $33 billion in pollution control and industrial waste disposal systems through to the year 2000. From July 1989 to June 1993, an estimated $350 million will be spent to control air pollution and $1.1 billion to control water pollution. Taiwan's Environmental Protection Administration is planning an island-wide pollution monitoring system. Between July 1989 and June 1993, the authorities plan to invest $1.2 billion in

solid waste disposal. Eight incinerators, 140 district and small-scale sanitary landfills, a computerized solid waste management system, and other resource recovery technologies will be purchased.

Computer Equipment: Sales of U.S. computer products are expected to grow 25 percent annually to over $2 billion in 1992 as U.S. suppliers capture 50 percent of the market. Sales of mainframes, small business computers, minicomputers, 32-bit microcomputers, and sophisticated peripherals will be brisk.

Electronic Components: Taiwan has become one of the world's largest exporters of personal computers, with 1989 exports totaling over $6 billion. Many of the highest value-added items in the typical export computer (system software, micro-controller, memory chips, and disk drive) were imported. The United States provided no less than $1.1 billion of electronic components in 1989. This is compared with $667 million and $851 million in 1987 and 1988, respectively.

Semiconductor Manufacturing Equipment: Taiwan is poised to become the world's fourth largest semiconductor manufacturer in the world after Japan, the United States, and Korea. In 1990, $900 million will be invested. Equipment and materials used in integrated circuit production--from wafer fabrication to packaging--are needed on Taiwan.

Automated Production Equipment: The automated production equipment market is projected to expand at an average annual rate of 25 percent through 1992, to reach $8 billion. The greatest demand will be for CAD/CAM systems, automatic guided vehicles and automatic warehouse equipment, industrial robots, and NC/CNC machine tools.

Industrial Process Controls (IPC): Imports may grow 16 percent per annum to over $1 billion by 1992. American suppliers should be highly competitive in the growing market for electronic/electric IPCs and computer-based control systems.

Telecommunications: The Directorate General of Telecommunications will spend some $2 billion over the next few years on an island-wide digital network system. Procurement for 1990, 1991, and 1992 is estimated at $400 million annually.

Mass Transportation Equipment and Services: The $15-billion Taipei rapid transit project, to be completed in 1999, will include several billion dollars worth of foreign procurement. The general engineering consultancy service for the $4 billion

Kaohsiung Mass Rapid Transit System, the engineering design service for the $10.3 billion West Coast Corridor High-speed Railway project, and the feasibility study for the new deep-water harbor on Taiwan are expected to be completed in one to two years. These projects will create engineering consulting service and major foreign purchase opportunities for U.S. firms.

Scientific Instruments: Sales of laboratory and scientific instruments--totaling $680 million in 1989--could increase 25-30 percent per year through 1992. The best sales opportunities include analytic instruments, electronic instruments, and material testing equipment.

Power Plants: The Taiwan Power Company's (Taipower) plan to build a fourth nuclear power plant had initially been slated for final approval by August 1990. However, it now faces stiff opposition from newly elected local officials and environmental groups. If the plant is approved, foreign equipment purchases would amount to $4.2 billion. Taipower also plans to purchase $825 million of air pollution control equipment between 1989 and 1993 for its thermal power plants and coal handling yards. Taipower will automate its transmission control system over the next seven years at a cost of $500 million, including $240 million in foreign procurement.

Petrochemical Plants: The Chinese Petroleum Corporation will construct a $588 million naphtha cracker in the second half of 1990. Formosa Plastics Corporation recently received permission to begin constructing a $240 million naphtha cracker plant in Kuanyin, which will entail $100 million in equipment purchases in 1990. The $1.3 billion Formosa Plastics petrochemical complex at Point Comfort, Texas, will offer U.S. suppliers huge equipment procurement opportunities in 1990.

Automobiles and Parts: In 1989, imports of American passenger cars rose 144 percent to over 54,000 units. In terms of units, American cars accounted for approximately one-third of all imports. Sales are expected to continue to grow at a very rapid rate when import duties are reduced from 40 percent to 30 percent, as scheduled by early 1991. Concurrent with the expansion in American car imports, the after-market for American parts and accessories is growing rapidly. In addition, some U.S. parts manufacturers have started to sell parts and components--on an original equipment manufacturing basis--to Taiwan's ten automobile assembly plants.

Medical Equipment and Pharmaceuticals: As a result of the imminent establishment of universal health insurance coverage, the medical market in Taiwan is growing rapidly. The total

health care products market has been increasing at an average 20 percent a year to approximately $1.5 billion in 1989. The United States accounted for a 27-percent market share of Taiwan's total healthcare imports ($145 million) in 1989. American firms are particularly competitive in the high end of the equipment market, as well as in medical services.

Building Supplies and Construction Equipment: Many Taiwan design and architectural firms are reaching out for new, high-quality imported products. The new-home market is large. The renovation market is even larger. On the construction equipment side, imports are playing a very important role in the numerous infrastructure development projects presently under way. Although complete figures are not yet available for 1989, the import growth rate for building supplies and construction equipment in 1988 was 42.2 percent. Total imports in 1988 were recorded at $1.3 billion. U.S. manufacturers of building supplies and construction equipment are rapidly gaining a larger import share.

Aerospace and Aviation Equipment: Eva Airlines, a newly formed carrier associated with Evergreen Shipping Company, purchased 26 U.S. aircraft worth $3.2 billion in October 1989. China Airlines recently announced that they would form a new subsidiary that is also expected to make significant purchases. Several other smaller private airlines have started operations over the last year. At the same time, several airports around the island are planning extensive expansion and renovation projects. All of these efforts are designed to make Taiwan into a regional hub for East Asia. In addition, the Taiwan authorities budgeted funds in June 1989 to purchase a scientific satellite in the near future.

Cosmetics: As disposable income rises on Taiwan, imports of cosmetics are growing rapidly. Total imports grew by 43 percent in 1987 and by nearly 90 percent in 1988, reaching about $40 million. (Figures are not yet available for 1989.) U.S. companies have an approximate 25-percent share of this market. The markets for imported cosmetics and toiletries is expected to continue to expand rapidly as imported products gain the advantage over local brands.

Food Processing, Hotel and Restaurant Equipment: Due to a general tendency toward increased consumption of Western-style food, food processing, food packaging, supermarket equipment, hotel and restaurant equipment imports from the United States are very strong. Seven-Eleven opened its 500th outlet on Taiwan in June, 1990. Western-style supermarkets are appearing even in the provincial towns. At least a dozen U.S. fast-food franchises presently operate on Taiwan. Moreover, local firms in the food preparation industry must also upgrade their equipment and machinery to compete with imported products.

Processed Foods: Sales of imported fruit juices, fruits, beef and convenience foods saw significant increases in 1989 and are expected to continue to grow over the medium term.

1991 TRADE SHOWS

AIT will sponsor several trade shows in 1991. U.S. firms may contact AIT at 886-2-720-1550 (fax 886-2-757-7162) or the Taiwan Desk at the Department of Commerce at 202-377-4957 for information about these events and other commercial services which AIT can provide.

12/30/90 - 02/03/91 (SA)	American Home Appliances Exhibition
05/15/91 - 05/19/91	Taipei Int'l Auto Show (TWTC)
05/24/91 - 05/28/91	Taipei Int'l Construc. Hardware, Houseware & Building Materials Show (TWTC)
06/04/91 - 06/10/91	COMPUTEX (TWTC)
09/17/91 - 09/21/91	Taipei Plastics (TWTC)
November 1991	Medical Show
11/19/91 - 11/23/91	Taipei Aerospace Technology Exh. (TWTC)
12/05/91 - 12/08/91	Taipei Int'l Travel Fair (SA)
12/19/91 - 12/23/91	Taiwan Building Materials Show (TWTC)

Key: ATC - The American Trade Center in Taiwan
TWTC - Taipei World Trade Center
SA - Sungshan Airport